



ARIZONA STATE RETIREMENT SYSTEM

3300 NORTH CENTRAL AVENUE • PO BOX 33910 • PHOENIX, AZ 85067-3910 • PHONE (602) 240-2000
4400 EAST BROADWAY BOULEVARD • SUITE 200 • TUCSON, AZ 85711-3554 • PHONE (520) 239-3100
TOLL FREE OUTSIDE METRO PHOENIX AND TUCSON 1 (800) 621-3778

*Paul Matson
Director*

MINUTES PUBLIC MEETING ARIZONA STATE RETIREMENT SYSTEM BOARD

**Friday, August 25, 2017
8:30 a.m.**

The Arizona State Retirement System (ASRS) Board met in the 10th Floor Board Room of the ASRS Office, 3300 N. Central Avenue, Phoenix, Arizona 85012.

Mr. Kevin McCarthy, Chair of the ASRS Board, called the meeting to order at 8:35 a.m.

The meeting was teleconferenced to the ASRS office at 4400 E. Broadway, Tucson, Arizona 85711.

1. Call to Order; Roll Call; Opening Remarks

Present: Mr. Kevin McCarthy, Chair
Mr. Tom Manos, Vice-chair
Mr. Clark Partridge (Joined the meeting at 8:37 a.m.)
Mr. Jim Hillyard
Mr. Michael Lofton
Mr. Michael Miller

Absent: Mr. Rene Guillen
Mr. Harry Papp

One vacant position.

A quorum was present for the purpose of conducting business.

2. Approval of the Minutes of the May 26, 2017 Public Meeting of the ASRS Board.

Motion: Mr. Tom Manos moved to approve the minutes of the May 26, 2017 Public Meeting of the ASRS Board. Mr. Jim Hillyard seconded the motion.

By a vote of 6 in favor, 0 opposed, 0 abstentions, 2 excused, and 1 vacancy, the motion was approved.

3. Presentation, Discussion, and Appropriate Action Regarding the ASRS Fiscal Year (FY) 2018 Audit Plan

Mr. Paul Matson, ASRS Director, introduced the topic of discussion and turned the presentation over to Mr. Harold Mackey, Internal Auditor, who presented on behalf of Mr. Bernard Glick, Chief Internal Auditor. Mr. Mackey noted the Internal Audit Division (IAD) has prepared an Audit

Plan for the agency that proposes the auditable activities for FY 2018, which is based on a Risk Assessment conducted by the ASRS executive and senior managers, under the oversight of the Operations, Audit and Legislative Committee (OALC) and in collaboration with the IAD. The total hours available to perform audits or audit-related work will be approximately 5,400. The IAD will report to the OALC on a quarterly basis to provide an update on their progress. The reports will contain the budgeted and actual hours for each assigned audit. Mr. Mackey advised the Board of the IAD staff makeup, and further noted that an explanation of the objectives, scope, estimated hours, and reason for each audit appears on pages 7-9 of the ASRS Internal Audit Work Plan for FY 2018. He concluded his discussion by responding to questions from the Board.

Mr. Jim Hillyard inquired if the 2,600 hours dedicated to employer audits had changed from the previous fiscal year. Mr. Mackey responded that they had not.

Motion: Mr. Clark Partridge moved to approve the Audit Plan for FY 2018. Mr. Michael Miller seconded the motion.

By a vote of 6 in favor, 0 opposed, 0 abstentions, 2 excused, and 1 vacancy, the motion was approved.

4. Presentation Regarding Government Finance Officers Association (GFOA) Financial Reporting Awards

Mr. Anthony Guarino, Deputy Director and Chief Operations Officer, announced the ASRS has been recognized by the GFOA for the twenty-eighth consecutive year as the recipient of the Comprehensive Annual Financial Report (CAFR) award. A Certificate of Achievement is presented by the GFOA to those government units whose annual financial reports are judged to adhere to program standards and represents the highest award in government financial reporting.

In addition, the ASRS received the GFOA Award for Outstanding Achievement for the 2016 Popular Annual Financial Report (PAFR).

Mr. Guarino further recognized the following staff for compiling the data and having a substantial roll in the receipt of these awards: Nancy Bennet, Erin Higbee, Jeremy Pond, John Maczko, Hong Mayhew, Rebecca Fox, Karl Polen, Lupita Breland, Kerry White and Nathaniel Brengle.

5. Presentation, Discussion, and Appropriate Action Regarding the ASRS Investment Program Updates

Mr. Karl Polen, Chief Investment Officer, introduced himself to the Board, noting the new CIO report is a much shorter format in comparison to the previous reports. He briefly reviewed the over and under-weights of each asset class, Total Fund positioning, and the historical and FY Total Fund performance. He further elaborated on the Investment Management Division's (IMD) current activities, their views of the market, and the investment risk reports. Mr. Polen concluded his discussion noting two of the major projects the IMD is currently working on that will impact and be visible to the Board include an ongoing program to upgrade the IMD's performance measurement systems. These measurements provide a thorough understanding of where excess returns and underperformances are coming from and are critical in the ability to evaluate the group's investment decisions to determine crucial areas in need of improvement, as well as

the areas that are performing well. The other area major activity entails updates to the Strategic Asset Allocation (SAA), which can be expected to come to the Board sometime in the coming months.

Mr. McCarthy stated he was very pleased with the investment reports, noting the volume is just right and the information proceeds in a logical fashion, which he found to be very useful.

6. Presentation, Discussion, and Appropriate Action Regarding Interim Changes to the ASRS Strategic Asset Allocation (SAA)

Mr. Al Alaimo, Sr. Portfolio Manager of Fixed Income, Cash and Liquid Alternatives, reviewed changes to the SAA reviewed and accepted with the consensus of the non-quorum Board at the February 24, 2017, non-quorum Board meeting. Recommended interim changes to the SAA from that meeting included the following:

- Increase the policy target for Private Debt to 12% from 10% (recent weighting approximately 10.1%)
- Expand the range for Private Debt to 8-16% from 8-12%
- Reduce the policy target for U.S. High Yield to 2% from 4% (recent weighting approximately 2.4%)
- Establish a range for U.S. High Yield of 0-6%

Mr. Alaimo noted the shift to a higher policy target for Private Debt and a lower policy target for U.S. High Yield will provide a benefit in higher expected returns and reduced volatility. In addition, Private Debt offers the most attractive opportunity in fixed income markets with high expected net returns available for investors willing to accept illiquidity and a delayed deployment of capital. The market opportunity for Private Debt is principally driven by regulatory constraints that make it unattractive for banks to hold illiquid loans or debt of below investment-grade credit quality.

Mr. Alaimo concluded his discussion with a detailed explanation of the Private Debt program, the type of loans Private Debt is comprised of and gave general examples of the loan and funding process for these types of investments.

Motion: Mr. Tom Manos moved to confirm changes to the ASRS Strategic Asset Allocation made by consensus of a non-quorum Board at the February 24, 2017, non-quorum Board meeting effective April 1, 2017. Mr. Clark Partridge seconded the motion.

By a vote of 6 in favor 0 opposed, 0 abstentions, 2 excused, and 1 vacancy, the motion was approved.

7. Presentation, Discussion, and Appropriate Action Regarding ASRS Budget Related Topics:

- a. Presentation/update of the ASRS Appropriated and Continuously Appropriated Budget Plans to Include the ASRS Administrative and Investment Spending Plans for FY 2018.**
- b. Presentation of the ASRS Appropriated and Continuously Appropriated Budget Request and the ASRS Administrative and Investment Spending Plans for FY 2019.**

Ms. Martha Rozen, Chief of Administrative Services, introduced the topic of discussion, stating the materials include the spending plan for FY 2018 and the budget request for FY 2019. Ms. Rozen commented on a few of the highlights, noting the spending and budget plans are set up to be flexible to meet the ASRS Strategic Initiatives. The budget request for FY 2019, include reductions to the following expenditures:

1. A decrease of \$225,000 in funding for the lump-sum base operating budget.
2. A decrease of \$300,000 in funding for the administration of the ASRS Long Term Disability (LTD) Program.
3. A decrease of five (5) appropriated full-time employees (FTE).

Ms. Rozen then turned the presentation over to Mr. Russ Levine, Procurement and Budget Manager.

Mr. Levine introduced himself to the Board, opening up his discussion with facts relating to the ASRS budget plan, noting all funds utilized by the ASRS are trust fund dollars, as general funds are not used to conduct the daily operations of the ASRS. Mr. Levine noted the full spending plan is presented to the Board; however, the subset of the spending plan is what is subject to legislative appropriations. The Legislature appropriates for the ASRS both the authority to spend the trust fund dollars, as well as the number of ASRS FTEs the ASRS can employ. Mr. Levine further reviewed the appropriations and continuous appropriations presented in the materials, noting the Board will be approving the funding for the continuous appropriations of the Budget Spending Plan, which do not require legislative approval.

Ms. Kerry White, Assistant Chief Investment Officer, provided the Board with a detailed explanation of the Budget Spending Plan for the Investment Management Division, noting the ASRS Investment Plan is designed to appropriately plan for the investment management costs and related consulting fees needed to meet the Board's investment objectives. Ms. White noted internal investment costs for the ASRS are approximately half of a basis point of the Total Fund, which is reflective of the IMD's continuous efforts to strive and look for ways to spend less and get more value for their expenditures.

Additional discussions ensued with questions from the Trustees.

Motion: Mr. Clark Partridge moved to approve an appropriated budget request for FY 2019 in the amount of \$24,642,700, an administrative spending plan of \$31,195,700, and an investment spending plan of \$145,409,300, as well as any private markets performance incentive and other fees when identified and paid. Mr. Michael Miller seconded the motion.

By a vote of 6 in favor 0 opposed, 0 abstentions, 2 excused, and 1 vacancy, the motion was approved.

8. Presentation, Discussion, and Appropriate Action Regarding the Alternate Contribution Rate (ACR) for FY 2018

Mr. Matson, Director, briefly introduced the topic of discussion advising the Board the agenda item was being discussed to clarify the ACR presented at the December 2, 2016, Board meeting. The ACR is 9.36% for the Pension and Health Insurance Supplement, and an additional 0.13% for LTD, for a combined ACR of 9.49% for FY 2018.

Motion: Mr. Clark Partridge moved to clarify the December 2, 2016, Board member consensus that the Alternate Contribution Rate (ACR) is 9.36% for Pension and Health Insurance Premium

Supplement, and an additional 0.13% for Long Term Disability (LTD), for a combined total ACR of 9.49% for fiscal year 2018. Mr. Jim Hillyard seconded the motion.

By a vote of 6 in favor 0 opposed, 0 abstentions, 2 excused, and 1 vacancy, the motion was approved.

9. Presentation and Discussion Regarding the ASRS Experience Study Education

Mr. Ryan Falls, Actuary for Gabriel, Roeder, Smith & Company (GRS), along with Mr. Joe Newton, GRS Pension Market Leader and Actuary, and Mr. Paul Wood, GRS Actuary, provided a detailed analysis of the ASRS Experience Study Findings, noting the purpose of the findings is simply informational data, the Board will not be adopting or taking action on any of the findings at the end of the presentation; the information is being provided as a means to help the Board make informed decisions when determining future contribution rates and will also assist them in understanding the actuarial liabilities of the ASRS Trust Fund.

Additional discussions ensued with questions from the Trustees; there were none.

10. Presentation, Discussion, and Appropriate Action Regarding the Director's Report as well as Current Events

Mr. Paul Matson stated he had nothing further to add regarding the Director's Report but would answer any questions the Board may have regarding the report; there were none.

11. Presentation and Discussion Regarding Informational Updates from Prior and Upcoming Committee Meetings

a. Operations, Audit and Legislative Committee (OALC)

Mr. Clark Partridge announced the next OALC meeting will be held October 4, 2017.

b. Investment Committee (IC)

Mr. Karl Polen announced the next IC meeting is scheduled to be held on September 29, 2017.

c. Appeals Committee (AC)

Mr. Tom Manos announced the next AC meeting is scheduled to be held on September 12, 2017

12. Board Requests for Future Agenda Items

No requests were made.

13. Call to the Public

No one from the public requested to speak.

14. The next regular ASRS Board meeting is scheduled for Friday, October 27, 2017 at 8:30 a.m., at 3300 N. Central Avenue, 10th Floor Board Room, Phoenix, Arizona.

Mr. McCarthy noted the next Board meeting is scheduled for Friday, October 27, 2017 at 8:30 a.m.

15. Adjournment of the ASRS Board

Motion: Mr. Jim Hillyard moved to adjourn the August 25, 2017, Board Meeting at 10:58 a.m. Mr. Tom Manos seconded the motion.

By a vote of 6 in favor 0 opposed, 0 abstentions, 2 excused, and 1 vacancy, the motion was approved.

Respectfully Submitted by:

Gloria Montiel
Board Administrator
ARIZONA STATE RETIREMENT SYSTEM